December 20, 1999

D.T.E. 97-120-B

Petition of Western Massachusetts Electric Company pursuant to General Laws Chapter 164, §§ 76 and 94, and 220 C.M.R. §§ 1.00 et seq., for review of its electric industry restructuring proposal.

ORDER ON COMPLIANCE FILING

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I. INTRODUCTION

On September 17, 1999, the Department issued its Order in the above-referenced proceeding. Western Massachusetts Electric Company, D.T.E. 97-120 (1999).[(1)] Pursuant to the Department's Order in D.T.E. 97-120, on October 18, 1999,[(2)] Western Massachusetts Electric Company ("WMECo" or "Company") submitted a compliance filing ("Compliance Filing") for the Department's review.[(3)] The Department conducted a technical session and evidentiary hearing on the Company's Compliance Filing. In addition, the Company responded to both written and oral requests for information from the technical session and record requests from the evidentiary hearing. Pursuant to the established procedural schedule, written comments were submitted by the Attorney General, Western Massachusetts Industrial Customers Group ("WMICG"), and the Associated Industries of Massachusetts ("AIM"). Reply comments were submitted by the Company. In this Order, the Department address the distribution rates and transition costs.[(4)]

II. TRANSITION COSTS

A. Introduction

WMECo submitted a compliance schedule to demonstrate that it has followed the Department's directives with regard to the recovery of transition costs (Exh. WMECo-Comp-1 at 4). The Company states that it has demonstrated compliance with 26 items associated with its transition costs that were accepted, modified and/or rejected by the Department in its Order (id.). The Company submitted revised calculations of its transition costs in response to the directives specified in D.T.E. 97-120 (id.). Unless otherwise directed, the Company calculated its transition costs using information submitted in its restructuring plan filing. The Company proposes to submit a reconciliation filing in the first quarter of 2000 (id.). The Company stated that it would reconcile amounts for 1998 and 1999 in that reconciliation filing (id.). Therefore, the Company states that it is seeking approval of the methods used in the calculations of the transition costs and charges, not the actual amounts (id.).

B. Millstone Return Disallowance

The Department did not allow the Company to earn a return on its unamortized Millstone 1 plant balance, post-shutdown and pre-decommissioning costs, end-of-life materials and supplies, and final nuclear core. D.T.E. 97-120, at 30. Additionally, the Company was not allowed to earn a return on the Millstone 2 and 3 plant balances during a specified period in which the units experienced extended outages. D.T.E. 97-120, at 48. In its calculation of the return disallowance on the Millstone units, WMECo eliminated only the return on equity component, rather than the overall rate of return (Exh. WMECo-Comp-1, exh.

13EC, sch. 1, at 12A and 12B).[(5)] The Attorney General opposed the Company's proposal to limit the calculation of the disallowance to the equity component (Attorney General comments at 12).

The Department did not limit the disallowance to the return on equity component. By limiting the disallowance to the equity component, the Company is not in compliance with the Department's Order. Therefore, in calculating the Millstone units' return disallowance, the Company is directed to use the Millstone units' overall rate of return on capital.

C. Unavoidable Nuclear Costs

The Department allowed the Company to collect its unavoidable nuclear costs separate from the nuclear expenses included in its performance-based ratemaking ("PBR") mechanism.[(6)] D.T.E. 97-120, at 95. The total unavoidable nuclear costs should be subtracted from the total nuclear expenses included in the PBR calculation and WMECo's share treated separately in the variable component of the transition charge (Exh. Tech. AG-4, at 8, 11). In its Compliance Filing, the Company subtracted WMECo's share of the unavoidable nuclear costs from the total unit expenses, rather than the total unit unavoidable nuclear costs from the total unit expenses. The method used by the Company in its Compliance Filing results in an over-recovery (Exh. Tech AG-4, at 8, 11). The Attorney General opposed the Company's calculation of its unavoidable nuclear costs (Attorney General comments at 15-16).

In calculating the PBR for its nuclear units, the Company did not properly deduct the unavoidable nuclear costs. Therefore, the Department finds that the Company is not in compliance with D.T.E. 97-120. The Company is directed to revise its PBR so that the total unavoidable nuclear costs for each unit are subtracted from the total unit expenses in the determination of net revenues. The actual amounts for the unavoidable nuclear costs will be determined in the Company's reconciliation proceeding.

The Department allowed for the Company to recover its fully-allocated generation operating costs through the generation operating costs/lost revenue component of the variable portion of the transition charge. D.T.E. 97-120, at 91-92. Included in the generating operating costs are the unavoidable nuclear costs (Tr. 29, at 4167). In its Compliance Filing, the Company proposes a method that would permit a double recovery of its unavoidable nuclear costs for 1999 by including the costs in the unavoidable nuclear costs component as well as the generation operating costs component (Exh. WMECo-Comp-1, exh. 13EC, sch. 1, at 3). This is not in compliance with the Department's Order. The Company is directed to revise the variable component of the transition charge to show that as long as the lost revenue/generation operating cost is recovering the unavoidable nuclear costs there would be no unavoidable nuclear cost component.

D. Regulatory Assets

1. Return on FAS 87 Pension Overfunding

The Company did not include a return on pension overfunding in the Compliance Filing. The Attorney General claims that while the order states that no amount should be included for the pension overfunding until divestiture, it also states that a return on the pension overfunding should be included at this time (Attorney General Comments at 14, citing D.T.E. 97-120, at 75). The Department's Order addressed the inclusion of postretirement benefits other than pensions ("PBOP") and pension amounts in the transition charge. D.T.E. 97-120, at 75. Because this section of the Order addressed the inclusion of amounts at the present time and at the time of divestiture, both pension and PBOP items were addressed. The language cited by the Attorney General, i.e., "the Department finds that the rate of 7.75 percent should be used in calculating the return component at this time," is directed to changing the PBOP interest rate from the 7.5 percent used by the Company in its filing. However, Section VI,C,5,c, of the Order, pertaining to recognition of pension overfunding, specifically states that no amount will be included in the transition charge at this time. Therefore, the Company's Compliance Filing is consistent with the Department's order.

2. FAS 109 Amounts

The Company has included revised amounts for: (1) Accelerated FAS 109, (2) FAS 109 Excluding Fossil/Hydro, and (3) FAS 109 Fossil/Hydro (Exh. WMECO-Comp-1, exh. 13EC at 6). The Compliance Filing is not the appropriate proceeding to review these changes. Until the Department approves updated FAS 109 amounts, the Company is directed to include the FAS 109 amounts proposed in Exhibit 13E in the transition charge calculation. The Company should update these amounts in its reconciliation filing. Further, at the time the Company reconciles its divestiture proceeds, the Company should include revised amounts for FAS 109.

3. FAS 109 Amounts Used in the Calculation of Net Deferred Taxes

In its computation of the FAS 109 component of the net deferred tax calculation, the Company incorporates the changes proposed for the FAS 109 amounts (WMECO-Comp-1, Exh. 13EC at 6, 12, 12A and 12B). The Company also makes additional adjustments to the FAS 109 amounts for FAS 109 not related to plant book basis and depreciation differences (Tr. 29, at 4217). The Compliance Filing is not the appropriate proceeding to review these changes. Until the Department approves an updated FAS 109 component of the net deferred tax calculation, the Company is directed to calculate the FAS 109 component of the deferred tax calculation based on the amounts used in Exhibit 13E. The Company should update these amounts in its reconciliation filing. Further, at the time the Company reconciles its divestiture proceeds, it should include revised amounts for FAS 109.

E. Deferral of Transition Costs

In its Compliance Filing, the Company indicated that, prior to reconciliation for actual costs, the transition charge level permitted under the rate reductions required by the Restructuring Act requires the deferral of $5.9 million in transitions costs in 1998, and $28 million in transition costs in 1999 (Exh. WMECo-Comp-1, at 5).[(7)] The Company proposes that any deferrals be amortized over twelve years, with carrying costs on the unamortized balances. No party commented on the Company's proposal (id.). The Restructuring Act provides that no carrying costs are allowed for any period beyond the year 2009 on any unamortized balance of costs allowable as transition costs. G.L. c. 164, § 1G(b)(3)(d). While it would be appropriate to defer recovery of the transition costs that could not be recovered now as a result of the rate reduction requirements of the Restructuring Act, no carrying costs would be allowed on any unamortized balance beyond the year 2009.

III. DISTRIBUTION TARIFFS

A. Revised Tariffs

In its Compliance Filing, WMECo submitted tariffs to be effective on November 1, 1999,[(8)] that include revised distribution rates (Exh. WMECo-Comp-1). The revised distribution rates were developed based on a cost of service study ("COSS") that used 1997 data (id. exh. 12). The proposed tariffs are intended to provide a 15 percent rate reduction calculated from the August 1997 baseline rates, that include a 2.4% temporary base rate credit, adjusted for inflation (id. at 2).[(9)]

The Company's Compliance Filing tariffs also include new and separate tariffs for: (1) Rate D-1, Residential Low-income, and (2) Rate D-3, Residential Space Heating Low-income (id.). The Company indicated that, consistent with D.T.E. 97-120, it withdrew and terminated certain schedules, riders, and adjustment clause (Exh. WMECo-Comp-1, Cover Letter at 3).[(10)] In addition, the Company filed revised tariffs that closed Rates I-1, I-3, PR, T-0, and T-4 to new customers (id. at exhs. 1, 2).

B. Cost of Service Study

1. Description

The Company's COSS, based on calendar year 1997 data, functionalized the Company's 1997 costs into distribution and "All Other" cost components (Exh. WMECo-Comp-1, exh. 12).[(11)] The COSS determined the Company's 1997 distribution cost of service to be $106.777 million (id., Cover Sheet).

The Company performed four adjustments to this distribution cost: (1) depreciation increase of $3.364 million;[(12)] (2) creation of $1.0 million storm reserve; (3) conservation and load management ("C&LM") decrease of of $4.392 million;[(13)] and (4) renewables cost of $3.688 million (id.). These adjustments resulted in a total distribution revenue requirement of $113.437 million that includes C&LM and renewables revenues of $11.434 million and $3.688 million, respectively (id. exh. 8).

2. Depreciation

The Attorney General, WMICG, and AIM oppose the Company's $3.364 million depreciation adjustment on the COSS (Attorney General Comments at 5-6; WMICG Comments at 5; AIM Comments at 2). The Attorney General and WMICG assert that this adjustment is inconsistent with Department restructuring precedent because any changes in a company's distribution rates require a thorough review of the costs included in a COSS and that a restructuring proceeding is not the proper forum to investigate distribution rates (Attorney General Comments at 6-7, citing Fitchburg Gas & Electric Light Company, D.T.E. 97-115/98-120, at 39 (1999) and Boston Gas Company v. Department of Public Utilities, 367 Mass. 92, 105 (1975); WMICG Comments at 5, citing D.T.E. 97-115/98-120, at 39 (1999).[(14)]

WMECo argues that the depreciation rates, based on more recent data, are consistent with D.T.E. 97-120 requiring WMECo to file an updated COSS (WMECo Comments at 17, 19).[(15)] WMECo claims that, like the other costs presented in the filed updated COSS that used 1997 data, the depreciation expense adjustment is reasonable and supported by evidence on record in this case (id. at 17). In addition, WMECo disputes the Attorney General's assertion that intervenors were not given the opportunity to litigate the depreciation study, noting that the Company provided the 1995 depreciation study to the Attorney General and the other intervenors early in the proceeding and that no objections were made (id. at 17-18). WMECo asserts that in fact the precedent established in Commonwealth Electric Company, D.T.E. 97-111, at 39-40 (1999) and in D.T.E. 97-115/98-120, at 39 (1999) provide that a reasonable revenue requirement reflecting current costs is the appropriate measure of unbundled rates in a restructuring proceeding (id. at 18).[(16)]

In its Order, the Department directed the Company to "unbundle its rates based on an updated historic COSS that properly functionalizes distribution and other component cost of service" consistent with the restructuring precedent established in D.T.E. 97-111 and D.T.E. 97-115/98-120. D.T.E. 97-120, at 153.

The Department notes that the Company has proposed to change its 1988 depreciation accrual rate based on a new depreciation study that used 1995 data. The record shows that, although such a new study was filed in this proceeding, no thorough review of the study was conducted by the parties and the Department. The Department finds that, consistent with the precedent established in D.T.E. 97-111 and in D.T.E. 97-115/98-120, the proper forum for determining a company's depreciation accrual rate is in a base rate proceeding and not in an electric restructuring case. Accordingly, the Department rejects the Company's proposed $3.364 million depreciation adjustment to its COSS.

3. Storm Fund Reserve

WMICG opposes the Company's proposal to adjust its COSS by $1,000,000 for a storm fund reserve for the same reasons that it opposes the depreciation adjustment described above (WMICG Comments at 5). The Company claims that its proposal is consistent with the creation of $1.0 million storm fund reserve in the restructuring settlements approved in Massachusetts Electric Company and Nantucket Electric Company, D.P.U. 96-25-A, at 11 (1997) and in Boston Edison Company, D.T.E. 96-23, at 68-71 (1998) (id. at 19). WMECo asserts that the Department has the discretion to approve a reasonable storm reserve in this proceeding and that WMICG has offered no justification for the Department to depart from a similar treatment in this case (id.).

The Department notes that, although storm funds were approved in other restructuring filings, the levels of those funds were determined through negotiated settlements that reflect appropriate utility-specific levels of reserves. A review of the record in this case indicates that there is no evidence to demonstrate to the Department that the requested amount represents a reasonable level of fund reserve appropriate to cover the future rate impacts on WMECo's expenses due to storms. The Department finds that the Company's proposal to adjust its COSS by $1,000,000 for a storm fund reserve is not consistent with D.T.E. 97-120. Accordingly, the Department rejects the Company's $1,000,000 storm fund adjustment to its COSS.

4. Other Adjustments to the COSS

At the evidentiary hearing, the Company proposed three changes to its COSS. First, the amount of $134,000, itemized as Licensed Projects under Account 928 (Commission Expenses) was erroneously allocated to the distribution function and should be transferred to the production function (Exh. Tech-01-AG-19; Tr. 29, at 4149). Second, only a portion of $155,000 itemized as Miscellaneous under Account 928 should be allocated to the distribution function, instead of the entire amount (Exh. WMECo-Comp-1, exh. 12, at 22; Tr. 29, at 4150). Finally, the Company claimed that the amount of $2,219,000 representing Sales Expenses (Account 912) should have been assigned to the distribution function instead of being placed under the "All Other" category of costs (Tr. 29, at 4200-4201).

WMICG states that the $134,000 under Licensed Projects and a portion of the $155,000 Miscellaneous expenses should be removed from the distribution function (WMICG Comments at 5 n.5).[(17)] As the Company earlier indicated, WMECo now proposes these two changes and revision of its COSS (WMECo Comments at 15). The Departments finds that these changes are necessary to correct the COSS.

WMICG opposes the Company's proposal to transfer from production to distribution the $2,219,000 Sales Expenses, claiming that the Company failed to meet its burden of proof (WMICG Comments at 5). The Company asserts that this amount affects the allocation of overhead expenses and "should have been assigned to the distribution function, consistent with the total O&M costs ($3,621,000) in Account 912 that were so assigned" (Company Comments at 15, citing Exh. WMICG-Comp-1, exh. 12, at 21). The Company adds that there is no evidence on record to rebut the testimony of its witness that the entire amount of $2,216,000 should have been allocated to the distribution function (id. at 15).

The Department directs the Company to provide detailed documentation of the manner by which the Company reconciles the amounts shown as "Sales Expenses" accounts shown on page 21 of the COSS with the same Sales Expenses accounts shown on page 39 of the same COSS. With appropriate documentation, the Department will allow the Company to include Sales Expense in the distribution COSS. In addition, in revising its COSS, the Department directs the Company to break down the "All Other" column into its functional components consistent with the Department's Order.

C. Functionalization of the Company's Earnings

In D.T.E. 97-120, the Department rejected the Company's proposed method for determining its distribution revenue requirement for the purpose of unbundling its rates. The Department stated, "[c]onsistent with the restructuring precedent established in D.T.E. 97-111 and D.T.E. 97-115/98-120, the Department directs the Company to unbundle its rates based on updated historic COSS that properly functionalizes distribution and other component costs of service." D.T.E. 97-120, at 153.

In its Compliance Filing, the Company submitted a COSS that used calendar year 1997 as the test year (Exh. WMECo-Comp-1, exh. 12). The Company states that, because 1997 predates restructuring, data from 1997 represents integrated utility operation (Exh. WMECo-Comp-1, exh. 12; Tr. 29, at 4187). During the test year, the Company, on an integrated basis, under-recovered its allowed rate of return (Exh. DTE-Comp-6 at 2, line 29, 34). The Company attributed its under-recovery to losses in the production function of its integrated operation (Tr. 29, at 4187). In order to base its distribution rates at a cost that does not include production function losses, the Company functionalized its net return and income taxes by calculating the cost of capital for distribution plant using the rate of return approved by the Department in its last rate case, 9.39 percent (Tr. 29, at 4187).

The Attorney General and WMICG state that the Company's actual 1997 net return and income taxes should be functionalized based on the level of rate base allocated to each function (Attorney General Comments at 7-8, WMICG Comments at 6). The Attorney General maintains that this is consistent with the method employed by other companies and is consistent with how the Company functionalized interest expense (id.). Both the Attorney General and WMICG state that there is no record evidence to support the Company's assertion that its distribution and transmission businesses earned their claimed cost of capital and that its production business is responsible for all of the earning shortfall for the combined operations (id.).

The Company states that all of the losses experienced during the test year were attributed to poor nuclear performance and were temporary in nature, and therefore were not likely to be recoverable (Tr. 29, at 4187). Therefore, the Company did not seek to recover these losses in a general rate proceeding. The Company states that while it did not receive sufficient revenues to cover its costs in 1997, it did incur a cost a cost of capital for its investment in distribution plant (Company Comments at 6).

The Company states that functionalizing net return and income taxes based on a rate base allocator would deny the Company a fair opportunity to earn a return on its investment in distribution plant (id. at 6-7). According to the Company, the Department cannot deny a return on generation assets based on the Company's mismanagement of those assets and, at the same time, accept the Attorney General's argument that there is no evidence in the record that the generation assets are responsible for the Company's losses (id. at 9).[(18)]

Functionalizing net earnings using a rate base allocator, as suggested by the Attorney General and WMICG, would place the losses that were caused by the production function on the distribution function. This result is caused by the unbundling of an integrated utility operation in a test year in which the production function incurred significant losses. The Department directed the Company to determine its distribution rates using an updated COSS. Because the losses were incurred by the production function, it would be unreasonable to establish distribution rates that under-recover the Company's costs by the return on the distribution plant. Therefore, the Department rejects using a rate base allocator to functionalize the net return and income taxes at this time.

For purposes of the Company's Compliance Filing, assigning the losses in earnings to the production function would be a more accurate representation of cost incurrence. The establishment of PBR guidelines will set the stage for investigation of the Company's distribution rates.[(19)] Accordingly, the Department finds that for the purpose of unbundling its rates, the method proposed by the Company in its Compliance Filing is accepted.

D. Rate Design

The base distribution charges in the filed tariffs are designed to recover the distribution revenue requirement determined in the updated COSS (Exh. WMECo-Comp-1, Cover Letter at 2; exhs. 1, 6, 8). The structure of the proposed rates is similar to the existing rates approved on an interim basis (except for the low-income rider) that unbundles the Company's costs into the functional components of distribution, transmission, transition, and standard offer service (id., exhs. 1, 2).

Except for Rate D-1, Rate D-3 and Rate T-2 further described below, the Department finds the proposed tariffs to be consistent with D.T.E. 97-120. Accordingly, the Department accepts those tariffs, subject to changes and modifications directed in this Order.

1. Tariffs for Low-Income Rate Classes

Since there are no existing tariffs for the low-income customers, the Company performed a number of steps in designing the proposed rates.[(20)] First, the Company applied the then-existing 35 percent discount to the pre-restructuring charges of Rates R-1 and R-3 to arrived at the pre-restructuring charges for Rates D-1 and D-3, respectively (Exh. WMECo-Comp-1, exh. 4). Next, the Company functionalized the energy charge, adjusted for inflation, into four components: distribution, transmission, standard offer, and transition (id., exh. 6, at 2, 4). After applying the 15 percent discount and including the 1999 charges for DSM and renewables specified in the Act, the Company noted that it was unable to provide the required 15 percent rate reduction even after setting the distribution charge equal to zero (id.; Tr. 29, at 4210-4211). To fully recover the transition charge and comply with D.T.E. 97-120, the Company recovered the remaining portion of the transition charge through a transition customer charge keeping the total customer charge discounted at 15 percent (id.; Exh. WMECo-Comp-1, exh.6, at 2, 4). The Company provided schedules showing that all customers in Rates D-1 and Rate D-3 will receive 15 percent reduction in their total monthly bills compared with the pre-restructuring rates adjusted for inflation (id. exh 7, at 3, 4, 7, 8).

The Attorney General notes that some customers under the proposed Rates D-1 and D-3 would experience bill increases based on the existing rates (Attorney General Comments at 18). The Attorney General argues that, since the proposed rates are based on a distribution revenue requirement that is approximately $3 million lower than the level used to determine the existing rates, there is no justification why the proposed rates would result in bill increases (id.). The Attorney General suggests that the Company be required to redesign its proposed rates to eliminate any bill increases to customers based on the existing rates (id.).

The Company claims that it designed Rates D-1 and D-3 in compliance with the Department's Order to develop separate tariffs for the low income customers (WMECo Comments at 24). The Company asserts that the new low-income tariffs provide the mandated 15 percent rate reduction at all levels of use (id. at 24-25, citing, Exh. WMECo-Comp-1, exh. 7, at 3, 4, 7, 8). The Company opposes the Attorney General's suggestion to redesign Rates D-1 and D-3 in order to eliminate bill increases over the current rates because the current rates are based on a rider which the Department rejected, and therefore not the correct basis for comparison (id. at 25).

The Department directed the Company to developed separate tariffs for low-income customers because its proposed low-income rider would result in the transition charge paid by low-income customers being discounted, and some customers receiving less than the mandated rate reduction. D.T.E. 97-120, at 169. The Department notes that the existing rates were based on the low-income discount rider, applied on Rates R-1 and R-3, which the Department has found to be inappropriate.

The proposed Low-income Rates D-1 and D-3 provide the required 15 percent rate reduction for all customers. The Act provides that the 15 percent rate reduction should be applied on the August 1997 rates, adjusted for inflation, and not on any existing rates. The Department finds that the proposed Rates D-1 and D-3 meet the rate reduction requirement of the Act. Accordingly, the Department rejects the Attorney General's proposal to revise Rates D-1 and D-3 in order to eliminate any bill increases over the current rates. The Department finds that the proposed Rates D-1 and D-3 comply with the Department's Order.[(21)]

2. Rate T-2

The proposed charges for Rate T-2 provide a 15 percent rate reduction on the basis of the class's revenue requirement (Exh. WMECo-Comp-1, exh. 8). The proposed Rate T-2 would provide rate reductions ranging from 14.7 percent to 15.3 percent (id., exh. 7, at 15,16; T-29).

To demonstrate the constraints in designing Rate T-2, WMECo considered another approach that includes a negative off-peak distribution charge (id., exh. 9). In this proposal the Company: (1) unbundled the inflation-adjusted pre-restructuring charges into the four functional components of distribution, transmission, standard offer, and transition charges: (2) introduced the Act-mandated DSM and renewables charges; (3) set both the on-peak distribution charge and off-peak transition charge to zero; and (4) determined the off-peak distribution charge as a residual which resulted in a negative charge (id.).

WMICG asserts that the Compliance Filing failed to meet the required 15 percent rate reduction for some customers in Rate T-2 (WMICG Comments at 2). WMICG notes that the problem of designing charges for Rate T-2, to assure that all customers will have the required 15 percent rate reduction, would be compounded when the standard offer charge would increase from the 1999 3.1 cents per KWH level to 4.5 to 5.0 cents per KWH as estimated by the Company (id. at 2-3).

WMICG notes that the solution suggested by the Department in D.T.E. 97-111, at 41 (1998), to reduce the transition charge, will not solve the problem because the proposed off-peak transition charge is already zero (id. at 3). WMICG concludes that the Department must direct the Company to redesign Rate T-2 to ensure that all customers will have the required 15 percent rate reduction (id.).

WMECo asserts that its proposed tariff for Rate T-2 complies with Department rate design method (WMECo Comments at 26). The Company, however, notes that such a method does not in every case results in a 15 percent rate reduction (id.). The Company suggests that in order to achieve a 15 percent reduction it would be necessary to: (1) create differentiated on-peak and off-peak standard offer charges; (2) use a negative distribution charge for the off-peak energy charge; or (3) use both demand and energy component in the standard offer charge (id.).

WMECo notes that beginning January 1, 2000, the standard offer charge will be based on the result of its standard offer solicitation (id. at 26). WMECo claims that a higher level of standard offer charge will introduce added difficulty in rate design because the on-peak and off-peak energy charges are not large enough to cover the standard offer price, rendering the use of differentiated standard offer price no longer viable (id.). In addition, if a standard offer service rate uses both demand and energy charges, this structure of rates will not match the Company's supply cost, which is in cents per KWH, that would consequently require a true-up mechanism to make up for any under- and over-collections (id.). Accordingly, WMECo proposes a negative distribution energy charge to ensure that all Rate T-2 customers receive the mandated 15 percent rate reduction (id.).

The Department recognizes the constraints binding in the process of designing Rate T-2. The Department notes, for example, that increasing the magnitude of the rate decrease, to provide at least a 15 percent rate reduction for all customers, would require the Company to reduce its on-peak distribution demand charge, or use a negative off-peak distribution charge.[(22)] Customers initially receiving a greater than 15 percent decrease would experience an even larger rate decrease. This would prevent the Company from fully recovering the class's distribution revenue requirement for the class. The Department does not intend to impose such a rate design method that would prevent the Company from fully recovering its distribution revenue requirement.

In the proposed design of Rate T-2, where the Company provides the 15 percent rate reduction on the basis of the class's revenue requirement, but would be unable to ensure that each and every customer would experience the mandated 15 percent rate reduction, the Department finds that the Company's proposed Rate T-2 complies with D.T.E. 97-120. Accordingly, the Department accepts it subject to any changes and modifications directed in this Order.

C. Reconciliation of Distribution Tariffs

In its Compliance Filing, the Company proposed tariffs based on distribution rates that become effective on a prospective basis. The Attorney General and WMICG filed comments in opposition to the Company's proposed tariffs. In Western Massachusetts Electric Company, D.T.E. 97-120, Initial Order on the Company's Restructuring Plan (1998) ("Initial Order"), the Department approved the Company's rates, subject to further review and reconciliation. If the distribution rates ultimately approved by the Department are different than those in effect, there will be a reconciliation for the time period from March 1, 1998 to the date that the new distribution rates go into effect. Consistent with the rate reduction requirements of the Restructuring Act, the Company would have been able to increase its transition charge by the amount that the distribution rates approved by the Department in the Initial Order were above the distribution rates ultimately approved by the Department. Therefore, the Company may offset its distribution rate over-recovery with its approved transition costs. The Company is directed to provide this reconciliation of distribution rates, with interest on the under-collected transition costs, in its next transition charge reconciliation filing.

IV. ORDER

Accordingly, after due consideration, it is

ORDERED: That the tariffs submitted by Western Massachusetts Electric Company on October 18, 1999 be and hereby are DENIED; and it is

FURTHER ORDERED: That Western Massachusetts Electric Company shall comply with the directives of this Order.

By Order of the Department,

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Janet Gail Besser, Chair

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James Connelly, Commissioner

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W. Robert Keating, Commissioner

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Paul B. Vasington, Commissioner

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Eugene J. Sullivan, Jr., Commissioner

1. On October 7, 1999, the Department received motions for reconsideration and/or clarification from: (1) the Attorney General, (2) Western Massachusetts Industrial Customers Group, and (3) Temple Beth El and Kodimoh Synagogue. On October 15, 1999, Western Massachusetts Electric Company submitted a response to the motions. On December 1, 1999, the Department issued an Order on the motions for reconsideration and/or clarification. Western Massachusetts Electric Company, D.T.E. 97-120-A, Order on Motions for Reconsideration and/or Clarification (1999).

2. The Restructuring Act provides that if the Department rejects a restructuring plan, the Department shall state the reasons, and the Company shall file an alternative plan addressing the Department's objections within thirty days of the Department's order. G.L. c. 164, § 1A(a). The Restructuring Act further provides that the Department shall review this alternative plan and issue a final order within sixty days of the filing of the revised plan. Id.

3. On November 1, 1999, after discussions with the Division of Energy Resources and the Attorney General, the Company issued a request for proposals to potential suppliers for standard offer service.

4. In a separate order, the Department will address the standard offer service request for proposals.

5. For the purpose of calculating its overall rate of return to be used in calculating the return component of the transition charge, WMECo's capital structure includes long-term-debt, preferred stock and common equity components. D.T.E. 97-120, at 96.

6. Unavoidable nuclear costs are those costs the Company incurs regardless of plant operation.

7. The Company anticipates that these deferrals would be different after other factors, such as a residual value credit for fossil and hydro generation asset divestiture, are reflected.

8. The Company stated that, if the proposed November 1, 1999 effective date is not possible and cognizant that rates are scheduled to change again by January 1, 2000 to reflect a new standard offer rate and an inflation adjustment, it does not object to making a comprehensive rate change on January 1, 2000 rather than a series of rate changes (Exh. WMECo-Comp-1, Cover Letter at 1).

9. The existing rates, effective on September 1, 1999, include the 15% rate reduction mandated by the Act.

10. The tariffs terminated consist of the Rates R-4, R-5, Low Income Rider, I-2, Demand Reduction Rider to T-2, Service Extension Discount Rider, Conservation Charge Rider, Energy Conservation Service Rider, and Retail Fuel Expense Adjustment Clause (Exh. WMECo-Comp-1, Cover Letter at 3).

11. The Company also presented a COSS that further categorized "All Other" into the functional cost components of production and transmission (Exh. Tech-DTE-6).

12. The Company indicated that this depreciation adjustment is based on a new depreciation study filed as Exh. AG-2-5 in D.T.E. 97-120 (Exh. WMECo-Comp-1, exh. 12, Cover Sheet, n.1).

13. The Company notes that this adjustment represents a decrease in the C&LM historical requirement compared to the C&LM rates mandated by the Act (Exh. WMECo-Comp-1, exh. 12, Cover Sheet, n.3).

14. The Attorney General argues that, by using the compliance filing process to increase its depreciation expenses, WMECo denies the Attorney General and other parties the opportunity to challenge the depreciation study and its assumptions (Attorney General Comments at 5 n.3). WMICG asserts that the instant proceeding is not a rate case nor a Section 93 (G.L. c.164) proceeding, and therefore the depreciation adjustment should be rejected (WMICG Comments at 5).

15. The Company claims that the $3.364 million depreciation adjustment represents the difference between the accrual rates of its 1988 depreciation study and the new study based on 1995 year-end data and filed as Exh. AG-IR-2-5 (WMECo Comments at 17).

16. WMECo claims that in D.T.E. 97-111, the Department noted that since the distribution costs "has less of an impact on the total costs . . . in a base rate proceeding ... [t]he Department in future rate proceedings will conduct a thorough review of the costs

included in the distribution rates and the manner in which the costs included in the COSS were functionalized and allocated" (WMECo Comments at 18, citing, D.T.E. 97-111, at 39-40). WMECo also claims that in D.T.E. 97-115/98-120, at 39 (1999), the Department indicated that a thorough review of the costs included in a COSS "is not within [the] scope of a restructuring proceeding but may be necessary in proceeding to set performance-based rates" (WMECo Comments at 18).

17. WMICG notes that the portion of the $155,000 Miscellaneous expense that should be allocated to the distribution function should be $68,800 (WMICG Comments at 5, n.5). The Company calculates the same amount based on a revenue requirement allocator (WMECo Comments at 15).

18. The Department did not allow the Company to earn a return on its unamortized Millstone 1 plant balance. Additionally, the Company was not allowed to earn a return on the Millstone 2 and 3 plant balances during a specified period in which the units experienced extended outages. D.T.E. 97-120, at 30, 48.

19. See, D.T.E. 99-84.

20. Discount for low-income customers are currently provided through a Low-income Rider applicable to Schedules R-1, R-3 (and R-4 and R-5) (Exh. WMECo-Comp-1, exh. 1, M.D.T.E. 1017E).

21. [21] The Department notes that the Company has proposed to designate the new Low-income tariffs as Rates D-1 and D-3. For the purpose of standardization in rate class designation, and to avoid or minimize confusion, the Department directs the Company to change the designation of Rate D-1 to "Rate R-2" and Rate D-3 to "Rate R-4."

22. In the past, the Department has rejected the use of a negative distribution charge. See, Cambridge Electric Light Company, D.T.E. 97-111, at 41-42 (1999); Boston Edison Company, D.T.E. 96-23, at 37 (1998).